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No. 00-1402

In The
SUPREME COURT OF THE UNITED STATES

INTERNATIONAL FIDELITY INSURANCE CO., INC.,
Petitioner,

v.

DRILL SOUTH, INC.,
Respondent.

On Petition For A Writ Of Certiorari To The
United States Court Of Appeals For The Eleventh Circuit

PETITIONER INTERNATIONAL FIDELITY INSURANCE CO.'S REPLY BRIEF

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QUESTIONS PRESENTED

1. Whether binding a Miller Act surety to a default judgment entered against the surety's principal in the same lawsuit and precluding the surety's assertion of defenses violates the surety's right to due process under the Fifth Amendment of the Constitution.

2. Whether the Eleventh Circuit's decision binding a surety to a default judgment entered against its principal in the same lawsuit creates a conflict within the Eleventh Circuit and with decisions in other Circuits.

PARTIES TO THE PROCEEDING

Petitioner is International Fidelity Insurance Company. Drill South, Inc. is the Respondent.

CORPORATE DISCLOSURE STATEMENT

Pursuant to Supreme Court Rule 29.6, Petitioner International Fidelity Insurance Company states that it is a privately owned company, has no parent company and no publically held company owns 10% or more of its stock

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PETITIONER INTERNATIONAL FIDELITY INSURANCE CO.'S REPLY BRIEF

International Fidelity Insurance Company, Inc. ("International Fidelity") respectfully files this Reply in support of its petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Eleventh Circuit.

ARGUMENT

I. **The Eleventh Circuit's Decision To Bind International Fidelity By The Default Judgment Entered Against Its Principal Is In Conflict With Decisions Of The Ninth Circuit.**

Drill South alleges that there is no inconsistency in the case law on the question of whether a surety is bound by a default entered against its principal because International Fidelity had notice and the opportunity to defend its bond principal, and International Fidelity was a "party or privy" to the underlying case. Focusing on the "party or privy" element, however, ignores the fact that cases from the Eleventh and Ninth Circuits holding that a surety is bound by a default against its principal involve a judgment bond. That is not the case here. There is no judgment bond at issue in this case.

Drill South also contends that International Fidelity misrepresents the holdings in United States v. Maryland Casualty Co., 204 F.2d 912 (5th Cir. 1953) and Fireman's Insurance Co. v. McMillan, 29 Ala. 147 (1856), by failing to mention the "party or privy" standard. Respondent's Opposition at 7-8. Drill South's allegation is without merit.

There is no dispute that International Fidelity was an active participant in the underlying litigation defending the claim of Drill South on the merits. In the cases cited by the Respondent, the respective courts concluded that, because (1) the surety was a party or privy and (2) the underlying bonds at issue were undertakings to be bound (e.g., judgment bonds), the surety would be bound by any

judgment entered by default or otherwise against the bond principal. Maryland Casualty, 204 F.2d at 915; McMillan, 29 Ala. 147.

In this case, the underlying bond was not an undertaking to be bound by a judgment. The holdings in Maryland Casualty and McMillan emphasizing that a prior judgment is binding on the surety only where the underlying obligation is an undertaking to be bound, are, therefore, not inconsistent with the surety's position in this case.

Furthermore, Drill South's assertion that there is no conflict between the Eleventh Circuit's ruling and decisions from the Ninth Circuit is erroneous. In United States v. Hayes, 369 F.2d 671 (9th Cir. 1966) and Axess International, Ltd. v. Intercargo Insurance Co., 183 F.3d 935 (9th Cir. 1999), the Ninth Circuit held that a surety is not bound by a default judgment rendered against its principal unless the surety's obligation is created by an undertaking to be bound. Id. at 940. These cases are similar to Maryland Casualty and McMillan. The Eleventh Circuit's decision in this case is, however, inapposite.

The "party or privy" standard must be analyzed in conjunction with, and not independent of, the nature of the underlying obligation. Otherwise, the critical fact that judgment bonds were at issue in each of the cases in which the surety was bound by a default entered against its principal would be rendered meaningless. Analyzing the "party or privy" standard independent of any consideration of the nature of the underlying bonds, as argued by Drill South, would result in the conclusion that a surety must be

bound by a default merely if the surety is a "party or privy," regardless of the nature of the underlying obligation. No case cited by Drill South supports this position. In this case, therefore, the "party or privy" standard is irrelevant because the surety's bond is not a judgment bond.

The bond at issue in this case is a Miller Act payment bond, not an undertaking to be bound by a judgment. Although International Fidelity was actively litigating the merits of Drill South's claim, the Eleventh Circuit's decision to bind it by the default judgment entered against Enviro-Group was error and is in conflict with decisions of the Ninth Circuit.

II. International Fidelity Was Denied Due Process When It Was Bound By The Default Judgment Entered Against Enviro-Group And Denied The Right To Present Its Defenses.

Conspicuously absent from Drill South's Opposition is any mention of the fact that when the district court entered judgment against the surety, International Fidelity was defending the merits of Drill South's claim in the litigation. International Fidelity was also litigating its counterclaim against Drill South. Thus, the issue is not, as Drill South asserts, whether International Fidelity had notice of the suit against Enviro-Group and the opportunity to defend. Respondent's Opposition at 3-6. Rather, the issue is whether International Fidelity, as a co-defendant and as assignee and subrogee of Enviro-Group's claims, was denied due process when the district court stripped it of its right to present claims and defenses in its own name and as assignee and subrogee of Enviro-Group.

Drill South's argument that International Fidelity is a victim of an alleged failure to timely oppose the entry of default against Enviro-Group is misleading and incorrect. Respondent's Opposition at 3. As the record in this case demonstrates, the default against Enviro-Group was entered (1) with the understanding that the default would not be binding on International Fidelity, and (2) after the district court acknowledged that the hearing during which the default was entered was not to be a substitute for a trial on the merits. Against the background of these facts, Drill South can not claim that International Fidelity prejudiced itself by sitting on alleged rights.

Further, there is no merit to Drill South's argument that the "notice and opportunity to defend"standard is equivalent to International Fidelity having "a fair opportunity procedurally, substantively and evidentially to contest the issue." Respondent's Opposition at 5. There is no dispute that International Fidelity had notice and the opportunity to defend itself since it was defending the merits of the claim. The issue in this case, however, is whether the district court's dismissal of International Fidelity's claims and defenses without affording it an opportunity to be heard on the merits denied International Fidelity due process. See, e.g. Societe Internationale pour Participations Industrielles et Commerciales, S.A. v. Rogers, 357 U.S. 197, 209, 78 S. Ct. 1087, 1094, 2 L.Ed. 2d 1255 (1958).

Finally, this Court has held that when one of several defendants who is alleged to be jointly liable defaults, judgment should not be entered against him until the matter has been adjudicated against all of the defendants. Frow v.

De La Vega, 82 U.S. 552, 554, 21 L.Ed. 60, 15 Wall. 552 (1872). As noted in Frow,

> [t]he defaulting defendant has merely lost his standing in Court. He will not be entitled to service of notices in the cause, nor to appear in it in any way. He can adduce no evidence, he cannot be heard at the final hearing. But if the suit should be denied against the complainant on the merits, the bill would be dismissed as to all the defendants alike the defaulter as well as the others. If it be decided in the complainant's favor, he will then be entitled to a final decree against all. But a final decree on the merits against the defaulting defendant alone, pending the continuance of the case, would be incongruous and illegal.

82 U.S. at 554.

The Eleventh Circuit's decision binding International Fidelity to the default judgment entered against its principal is contrary to this Court's decision in Frow. After binding International Fidelity to the default, any opportunity to address the merits of the underlying case was lost. Frow assumes that, following the entry of default against one party, the underlying suit would be resolved on the merits. Id. According to Frow, however, should the underlying suit be dismissed, it would be dismissed against all defendants, including the defaulter. Id. The Eleventh Circuit's decision in this case renders the Frow analysis meaningless because a surety bound by a default entered against its principal would never have the opportunity to litigate the merits of the underlying action.

III. Drill South Distorts The Agreement of Indemnity, Which Contemplates That The Surety May Assert Affirmative Claims of its Principal, Not Defend The Bond Principal.

Drill South argues that International Fidelity confuses its right to defend under the Agreement of Indemnity with the obligation to defend. Respondent's Opposition at 8-9. Drill South's argument distorts the Agreement of Indemnity, which provides that the Surety may assert the affirmative claims of its principal and does not require or obligate the surety to defend its bond principal.

The Agreement of Indemnity assigns the bond principal's right to contract funds and claims related to those funds to the surety. The assignment must be read in conjunction with the Agreement of Indemnity's "Attorney-in-Fact" provision, which provides, in relevant part:

> The Contractor and Indemnitors hereby irrevocably nominate, constitute, appoint and designate the surety as their attorney-in-fact with the right, but not the obligation, to exercise all of the rights of the Contractor and Indemnitors assigned, transferred and set over to the Surety in this Agreement . . .

In this case, the assignment and other provisions of the Agreement of Indemnity afforded International Fidelity the right to assert its principal's claims. These provisions do not create the right or obligate the surety to defend its bonded principal. Rather, they are meant to assist the surety in vesting its rights in, among other things, bonded

contract funds and claims that may arise out of the underlying construction contract. See Hutton Construction Company, Inc. v. County of Rockland, 52 F.3d 1191 (2nd Cir. 1995). By upholding the district court's decision to bind the surety to the default entered against the bond principal, the Eleventh Circuit created an obligation that a surety must either defend its principal or suffer the consequences of being bound by the default. There is no right or obligation of the surety to defend its bond principal in the Agreement of Indemnity. Also, the Eleventh Circuit's decision places judicial conditions and constraints on the surety's contract right to assert claims.

The "Settlements" clause of the Agreement of Indemnity also provides that:

> The Surety shall have the right to adjust, settle or compromise any claim, demand, suit or judgment upon the Bonds, unless the Contractor and the Indemnitors shall request the Surety to litigate such claim or demand, or to defend such suit, or to appeal from such judgment, and shall deposit with the Surety, at the time of such request, cash or collateral satisfactory to the Surety in kind and amount, to be used in paying any judgment or judgments rendered or that may be rendered, with interest, costs, expenses and attorney's fees, including those of the Surety.

The express language of the Agreement does not provide that the surety has a "right" to directly defend its principal. Instead, the surety may take steps to protect itself, by, for example, settling and adjusting claims.

The Eleventh Circuit suggests that International Fidelity needed to directly assume the defense of Enviro-Group. This would upset customary practices in the surety industry since sureties do not, as a practice, directly assume the defense of their bond principals. Additionally, in this case, International Fidelity could not have entered an appearance on behalf of Enviro-Group because the surety had a cross-claim for indemnity pending against Enviro-Group. The Eleventh Circuit's holding would require International Fidelity to represent and assert claims on behalf of both parties in the underlying action. This is untenable. The conflict that the Eleventh Circuit's position would create justifies International Fidelity's position, as supported in other courts, that International Fidelity was not required to enter an appearance on behalf of its principal. United States ex rel. Vigilanti v. Pfeiffer-Neumeyer Const. Corp., 25 F. Supp. 403, 405 (E.D.N.Y.).

CONCLUSION

For the reasons stated herein and for the reasons stated in its petition for certiorari, International Fidelity submits that this case presents a question of federal law that is of substantial importance - whether a Miller Act surety is denied due process when it is precluded from defending its interests by operation of a default judgment entered against its bonded principal in the same lawsuit in which the surety is actively defending. The writ should therefore be granted to allow this Honorable Court to reconcile the conflict that exists between the decision of the Eleventh Circuit in this case and those of the Ninth Circuit in Hayes and Access International. Finally, the writ should also be granted to clarify for the Circuits the rights and obligations of a surety.

Accordingly, Petitioner International Fidelity Insurance Company respectfully requests that its Petition for certiorari be granted.

Respectfully submitted,

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